

## Chapter VII Special Considerations for Direct Loan Schools

### A. Background

Schools that participate in the Federal Direct Loan program have similar requirements as those that participate in FFEL. However, because there are differences in the process, the following information may be helpful to reviewers. Since the case management process includes gathering all relevant information pertaining to the school, reviewers are to contact the school's client account manager to gather information pertaining to Direct Loan participation at the school prior to the program review.

### B. School Origination Options

Reviewers should determine the origination option in which the school participates. There are three school origination options: Standard Origination, Origination Option 1, and Origination Option 2. These options define which loan processing functions a school performs and which functions ED's Loan Origination Center (LOC) performs. The origination option of the school is available on PEPS. A brief explanation regarding each option follows.

Any school approved by ED to participate in the Direct Loan Program may participate as a **Standard Origination** school. At this level, responsibility and control are shared between the school and the LOC.

- **Origination Option 1** schools perform more loan processing functions than Standard Origination schools, but the LOC still controls certain functions.
- **Origination Option 2** schools have the most responsibility, but can choose to have the LOC do certain loan processing functions for them.

The main difference between Option 1 and Option 2 schools is that Option 1 schools may process prom notes, and Option 2 schools may process both prom notes and draw down cash.

The following chart shows how responsibility for processing Direct Loans is divided between schools and the LOC for each school origination option:

<b>Responsibility</b>	<b>Standard Origination</b>	<b>Origination Option 1</b>	<b>Origination Option 2</b>
Create loan origination records	❖	❖	❖
Transmit loan origination records to LOC	❖	❖	❖
Prepare promissory note	LOC	❖	❖
Obtain completed/signed promissory note	LOC	❖	❖
Send promissory note to LOC	N/A	❖	❖
Calculate need for Direct Loan funds	LOC	LOC	❖
Request Direct Loan funds from GAPS	LOC	LOC	❖
Receive funds from GAPS	❖	❖	❖
Disburse loan funds to borrowers	❖	❖	❖
Create disbursement records	❖	❖	❖
Transmit disbursement records to LOC	❖	❖	❖
Perform reconciliation	❖	❖	❖
<b>Legend:</b>  ❖ = school's responsibility LOC = LOC's responsibility N/A = not applicable			

## C. School Responsibilities

Schools are responsible for assuring that only students and parents who are eligible to borrow Direct Loans receive funds from the program. There are numerous borrower eligibility requirements outlined in 34 CFR 685.200, 34 CFR 685.300 (b) and 34 CFR 668, Subpart C. These requirements are similar to the eligibility requirements for other Title IV programs. Although the list is not all-inclusive, reviewers should be aware of the following school responsibilities. These responsibilities will be explained in further detail in this section:

- a. Originating Direct Loans (34 CFR 685.301)
- b. Drawing down and disbursing Direct Loan proceeds (34 CFR 685.303 (b), 34 CFR 685.303(c), and 34 CFR 668.164)
- c. Counseling students (34 CFR 685.304 (a) and 34 CFR 685.304 (b))

- d. Reconciling school-based Direct Loan records with records in ED's Direct Loan database (34 CFR 668.21 (b))
- e. Carrying out administrative and fiscal management functions (34 CFR 668 Subparts B, K and L; 34 CFR 685.309)
- f. Reporting changes in borrower enrollment status to ED (34 CFR 685.309 (b))
- g. Implementing a quality assurance system, as established by ED (34 CFR 685.300 (b)(9))

For a complete listing of school functions see 34 CFR 685.300.

## **D. Review Procedures**

To become the official and legally binding obligation between the borrower and ED, a note must be executed by the borrower and funds disbursed to the borrower. A loan must also be "booked." There are three components needed to book a loan:

- the LOC accepts a loan origination record;
- the LOC accepts a promissory note; and
- the LOC accepts a disbursement record.

### **1. Loan Origination**

Procedure: Reviewers should check loan origination information for each Federal Direct Loan recipient in the sample (34 CFR 685.301).

Regardless of their origination option, all Direct Loan schools are responsible for originating loans. The Direct Loan origination process is similar to the loan certification process in the FFEL Program. In both cases, schools provide loan data on the eligibility of borrowers to receive loans.

Schools originate a Direct Loan by first creating a loan origination record (LOR) and then "originating" it in the software. This stamps the LOR with the important "origination date." (Note: It is possible to create an LOR and save it, but not originate it.) The process of originating a Direct Loan, as opposed to simply creating it, can be likened to the actual certification of an FFEL program loan. The loan origination record is the foundation for any Direct Loan. Without it, no other processing can take place.

Schools (or their third party servicers) send loan origination records directly to the LOC. When a loan origination record is accepted by the LOC, two events occur:

- a. The LOC sends a disclosure statement to the borrower. (Schools can request ED to authorize them to print and distribute disclosure statements to borrowers, rather than having the LOC do it).
- b. Depending upon the school's origination option, either the school or the LOC prints promissory notes and collects the signed notes from borrowers.
  - The LOC prints and collects signed promissory notes for Standard Origination schools.
  - Origination Option 1 schools and Origination Option 2 schools have the authority to print and collect signed promissory notes, although they can allow the LOC to do it for them. If these schools collect signed promissory notes from borrowers, they must forward the notes to the LOC.

When the LOC accepts a completed and signed promissory note, whether it comes from a borrower or a school, it sends an acknowledgement to the school.

### ***Helpful Hints for Origination:***

The Direct Loan Software contains useful information regarding the origination and disbursement information for each Direct Loan student. If the school is an EDEExpress user, reviewers may find it helpful to have the school print information from the origination and disbursement tabs for each Direct Loan student in the sample. This will show the borrower information, promissory note information, and the loan information for **each** loan (the student may have Sub, Unsub, and/or PLUS).

There is also a report that can be run from the Direct Loan Software called the Origination Report. The report can be printed using the "multiple student" option on the software. The SSN of every Direct Loan student in the sample can be entered into the software to receive origination information for **each** Direct Loan originated.

Reviewers should be aware that many schools do not use EDEExpress, nor is it required. If the school is not an EDEExpress user, reviewers should ask the school to provide the origination information for each student in the sample from whatever system the school uses. This information should include the loan information for **each** loan borrowed by the student.

## **2. Drawdowns and Disbursements**

Procedure: Reviewers should check disbursement information for each Federal Direct Loan recipient in the sample (34 CFR 685.303 (b), 34 CFR 685.303(c), and 34 CFR 668.164).

When a school is ready to receive Direct Loan funds, it (or the LOC on the school's behalf), makes a drawdown request to ED's Grant Administration and Payment System (GAPS). The large percentage of Direct Loan schools are Option 2 and thus make their own drawdowns. The following is the process for all schools:

- ❖ Origination Option 2 schools have the authority to make their own drawdown requests. Requests are made on the basis of estimates for disbursing Direct Loan funds. Requests for funds do not have to be borrower-specific.
- ❖ The LOC must make drawdown requests for Standard Origination schools and Origination Option 1 schools. The requests must be borrower-specific.

Before disbursing any funds, schools must verify that:

- a signed, completed promissory note has been returned by the borrower;
- the borrower remains eligible to receive Direct Loan funds; and
- the borrower is eligible to receive the amount of Direct Loan funds disbursed.

For a disbursement to be made, a valid, completed promissory note (signed, dated, any changes initialed and dated) must be on file at the school or the LOC. If a valid, completed promissory note is not on file, the school may be liable for any disbursements. Reviewers should be aware about the use of the Master Promissory Note (MPN), since multi-year schools may have the student sign one note for their entire borrowing career. Under the multi-year feature many students will be able to obtain additional loans without having to sign a new MPN for each academic year. Multi-year schools can accept a promissory note from a previous year or a previous Direct Loan school. Single-year schools can only accept a promissory note from the current academic year at that school. Reviewers should be aware that there are differences between multi-year and single-year schools. For more information regarding the use of MPN, please refer to 34 CFR 685.102, Dear Colleague GEN-98-25, 34 CFR 685.402 (f), Dear Partner Letter GEN 00-03, and Direct Loan Bulletins DLB 00-05 and 00-11.

Standard Origination schools and Origination Option 1 schools must disburse funds to specific borrowers for whom drawdown requests were made. If a school doesn't disburse funds to the intended borrower, the funds must be returned to ED.

Origination Option 2 schools should time their requests for funding on the basis of when they expect to disburse funds. These schools may disburse available Direct Loan funds to any eligible borrower.

All schools must send their disbursement records to the LOC within 30 days of the disbursement date. In addition, if Direct Loan funds are not disbursed within three business days of the date they were received from ED, a school must either return the funds promptly, or if the school meets the criteria for excess-cash tolerances in 34 CFR 668.166(b), within seven days.

### ***Helpful hints for Disbursement:***

Again, remember that many schools do not use EDEExpress. Some schools may use their own system or private vendors. Other schools may use a combination of EDEExpress and their own system. In these cases, reviewers should ask the school to provide them with the Origination and Disbursement information from their own system that would be found on the Origination and Disbursement Tabs of the Direct Loan Software (if the school were an EDEExpress user). This information should include the disbursement information for **each** loan borrowed by the student.

For schools that do use EDEExpress, reviewers may find it useful to have the school print out the disbursement screen of the Direct Loan Software for each Direct Loan recipient in the sample. This screen will show the anticipated disbursements and the actual disbursements for each loan.

Reviewers may also request a "List-Actual Disbursement" report from the Direct Loan software. This report can be produced for single students or multiple student records. This report will provide reviewers with a disbursement history for all students in the sample.

### ***Other Reports in EDEExpress that may be helpful for reviewers:***

- 4 ***Measurement-Booked Status Report*** - This report can be run from the EDEExpress Software. It contains a list of disbursement transactions with status flags for origination, promissory note, and disbursements.

## **3. Loan Counseling**

Procedure: Reviewers should check to ensure that loan counseling requirements have been met (34 CFR 685.304 (a) and 34 CFR 685.304 (b)).

Schools participating in the Direct Loan Program are required to conduct entrance loan counseling and exit loan counseling for students. Reviewers should ensure that these requirements are met at a Direct Loan School just as

they need to be met at an FFEL school. Since many processes are becoming electronic, loan counseling is not necessarily a paper process. Both FFEL and Direct Loan schools can access web-based programs provided by FFEL lenders or the Direct Loan Program to conduct loan counseling.

#### **4. Reconciliation**

Procedure: Reviewers should check to ensure that the school has reconciled Direct Loan funds (34 CFR 668.24 (b)).

Reconciliation is a process by which a school verifies that its Direct Loan records match the LOC's.

**Monthly reconciliation:** There is a monthly reconciliation process using a Direct Loan School Account Statement (DLSAS). The DLSAS is similar to a bank statement. It contains cash and loan record information that schools can use to compare the information in their databases with the information that the LOC has. The LOC sends the DLSAS to each school on a monthly basis. Since reviewers will ultimately be reviewing the past two academic years at a school, they should request the latest DLSAS from the school for the current academic year to determine if the school is current in the reconciliation requirements. The school has completed its monthly reconciliation when:

- ❖ All differences between the DLSAS and the school's internal records (Direct Loan System and business office system) have been resolved or documented.
- ❖ Timing issues have been identified and will be tracked for reconciliation in the next month's DLSAS.
- ❖ Any necessary corrective actions have been taken to ensure that all the prior month's issues will reconcile in the following month.
- ❖ All reconciliation efforts have been documented for future reference and review.

If the report shows the school is not in balance, reviewers should take a closer look at the monthly reconciliation process by reviewing the reconciliation history at the school to determine what process and procedures are in place at the school for monthly reconciliation requirements. Reviewers can also refer to Appendix P for more detailed information and helpful tools about the reconciliation process.

Schools may be receiving DLSAS reports for up to three academic years each month. The concurrent reconciliation efforts may result in overlapping cash detail data, such as when a drawdown has been split between award years. These multiple-year reconciliation efforts will sometimes reveal global issues at the school that need to be resolved.

*If reviewers determine that Direct Loan reconciliation is an issue that needs to be included as a finding, please refer to Program Review Item # 27.*

**Year-end closeout:** There is also an annual reconciliation process, which is called the "year-end closeout." It is similar to monthly reconciliation because the main purpose is for schools to match their internal records with the LOC's. However, instead of focusing on a single month, it addresses the entire academic year. Closing out is the process of reconciling all school information at the LOC and of bringing all ending cash balances to \$0.

The year-end closeout process is complete when:

- ❖ The school and the LOC each show a cash balance of \$0, indicating that the school has accounted for all Direct Loan funds received from ED.
- ❖ All LOC transaction records match up to all school Direct Loan System transactions and business office transactions.
- ❖ All actual disbursement records are booked at the LOC, so that the DLSAS reflects a \$0 unbooked balance.

Reviewers can determine if the school has reconciled prior award years by reviewing a copy of the school's 732-LOS file. This file provides ED's official ending cash balance for the school as of the date of the report, based on the LOC's records. The 732-LOS file is sent by the LOC to the school and comes as two text files—a summary file and a loan detail file. The chief distinction between the DLSAS and the 732-LOS is that the DLSAS contains data for a specific month, while the 732-LOS contains year-to-date cumulative data. If this file indicates that the school is in balance, this would be a good indicator that reconciliation is not a major problem.

If the report is not in balance, reviewers should take a closer look at the monthly reconciliation process by reviewing the reconciliation history at the school to determine what process and procedures are in place at the school for monthly reconciliation requirements.

Reviewers can also refer to Appendix P for more detailed information and helpful tools about the DL reconciliation process.

*If reviewers determine that Direct Loan reconciliation is an issue that needs to be included as a finding, please refer to Program Review Item # 27.*

## **5. Administration, Fiscal Control and Fund Accounting**

Procedure: Reviewers should check to ensure that the school is in compliance with requirements for administrative capability, fiscal responsibility, and fund



accounting can be found in 34 CFR 668, Subparts B, K, & L and 34 CFR 685.309. Reviewers should consider these requirements when conducting the fiscal portion of the review.

The fiscal responsibility requirements for Direct Loans are similar to that of all other Title IV programs. Some of the highlights of the requirements related to maintaining and accounting for funds at Direct Loan schools are as follows:

**Maintaining and Accounting for Funds** - All Direct Loan schools must maintain a bank account into which ED transfers or the school deposits Direct Loan funds. The account must be Federally insured or secured by collateral of value reasonably equivalent to the amount of Direct Loan funds in the account.

- ❖ A school is not required to maintain a separate account for Direct Loan funds unless ED specifies otherwise.
- ❖ Although Direct Loan funds may be kept in the same account with other Title IV funds, ED recommends that a separate account be established for Direct Loan funds. This separation of funds will help the school's cash management of Direct Loans. Reference: 34 CFR 668.163(a)(1)

**Interest-Bearing or Investment Account** - Except in certain instances, the account in which Direct Loan Program funds are deposited must be an interest-bearing account or an investment account. Please refer to 34 CFR 668.163(c) for specific requirements.

As with other Title IV programs, Direct Loan schools must maintain their financial records in accordance with the record-keeping requirements in the Title IV General Provision regulations (34 CFR 668.24).

**Excess Cash** - Excess cash is any amount of Direct Loan funds that a school does not disburse to students or parents by the end of the third business day after the school received the funds from ED. Unless a tolerance applies, a school must promptly return to ED any amount of excess cash in its bank account. Reference: 34 CFR 668.166

**Tolerances** - If a school draws down Direct Loan funds in excess of its immediate cash needs, the school may maintain the excess cash balance in its bank account only under the following situations:

- ❖ During peak enrollment periods, a school may maintain excess cash in amounts of less than 3 percent of the school's total prior-year drawdowns.
- ❖ For periods other than peak enrollment, a school may maintain excess cash in amounts of less than 1 percent of the school's total prior-year drawdowns.

For both these tolerances, a school must eliminate the excess cash balance by disbursing funds to students or parents within seven calendar days.

- ❖ This means the school has a maximum of 10 calendar days to eliminate excess cash that qualifies under tolerance rules: the three business days plus the seven calendar days.

Note: Standard Origination schools and Origination Option 1 schools receive funds that are borrower specific. These schools cannot disburse funds to any borrower other than the borrower for whom the funds were intended.

**Idle Cash** - Cash that has been disbursed becomes idle cash if and when it is returned to the school's Title IV account(s). This return may be due to a refund or other circumstances. For example, a student might receive a disbursement, but later decides to return all or a portion of the loan proceeds to the school.

A school may maintain idle cash in its Federal bank account for up to seven calendar days to disburse it to, or on behalf of, the student. An Origination Option 2 school also may disburse idle cash to other borrowers. Provisions concerning excess cash in 34 CFR 668.166(b) do not apply to idle cash.

**Returning Direct Loan Funds** - When Direct Loan funds are returned by a school to comply with the HEA or applicable regulations (for example, dealing with excess cash or a refund) the loan fee and any interest that has accrued on all or the appropriate portion of the funds is refunded to the borrower.

When funds are returned as a payment by a school, and it is more than 120 days after they were disbursed, the borrower still must pay the loan fee and interest on the amount.

*Reviewers should refer to Program Review Item #11 for further information regarding Return of Title IV (including Direct Loan funds).*

## **6. Reporting Changes in Borrower Enrollment Status to ED**

Procedure: Reviewers should check to ensure that the school has complied with the reporting requirements for the Student Status Confirmation Report (SSCR).

Federal law requires all Title IV schools-including Direct Loan schools- to verify and/or complete and return any Student Status Confirmation Report (SSCR) that ED sends it (34 CFR 685.309 (b)).

Within 30 calendar days of the date the SSCR Roster File is placed in a school's Title IV WAN electronic mailbox, the school must review the data, make any

needed changes, and send NSLDS an SSCR Submittal File through Title IV WAN.

See Program Review Item 33 for more information regarding SSCR Reporting for both FFEL and Direct Loan Schools.

## **7. Implementing a Quality Assurance System**

Procedure: Reviewers should ensure that the school has a quality assurance system with both a qualitative and quantitative assessment.

Schools must develop and maintain a Direct Loan quality assurance system. The quality assurance (QA) component of the Direct Loan Program is a requirement of all institutions participating in the program. QA is included in the statute authorizing the Direct Loan Program, as well as in the regulations, 34 CFR 685.300 (b) (9), as part of the Program Participation Agreement.

The quality assurance component of the Direct Loan Program is being revisited and new guidance will be provided to schools in the near future. In the meantime, reviewers should ensure that Direct Loan institutions have a quality assurance component that includes a qualitative and quantitative assessment.

## **E. Other References for Direct Loans**

[Direct Loan Bulletins](#)

[Federal Direct Loan Regulations](#)

[Cash Management Regulations](#)

[2001-2002 Student Financial Aid Handbook, FFEL and Direct Loan Section](#)

Direct Loans School Guide (A Better Way to Borrow), Available from the Direct Loan Staff or SFA Publications,

[Electronic Version of Direct Loan School Guides](#)

Appendix C (for Direct Loan sample Interview Questions)

[EDExpress Software](#)

<http://lo-online.ed.gov/>